WAR TIME BORROWING BY THE GOVERNMENT

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We have not been a borrowing nation and it is a new departure for us to have recourse to loans to provide for our needs. This is very apparent if we compare our national debt with that of other countries. Before the war, ours was only about $11 per capita, while that of England and Germany was about $75 each and that of France about $160. The war has changed this and, as closely as one can estimate, our per capita debt has risen already to about $70, while that of England and France is over $500 each and that of Germany about $350. We are dependent on our own resources, and it is our own people who must find the funds for financing our expenditures. We borrow at home and require no special safeguards for our bonds, such as some nations have been forced to provide in order to interest foreign capital. With us there are no questions involved of pledging certain revenues, of giving collateral security or of having lottery features. The simple promise to pay of our government is sufficient, and the main questions which our authorities have to consider are the amount and frequency of the offerings, the price of issue, the rate of interest, the length of time which the bonds are to run and whether they are to be taxable or not.

It is the policy of our government that its loans shall be offered for public popular subscription without discrimination, that they shall be issued at par and that no commissions or advertising expenses shall be paid. There can be no disagreement as to the first proposition, the second and third are somewhat open to question. European governments have never hesitated to issue bonds at a discount, realizing that this is simply a method of expressing the interest rate to be paid. In addition, there is a certain appeal to the investor in a bond at a discount, which is lacking in one issued at par, as experience has shown that in the former case there is as a rule more chance of the market price advancing towards par, than in the latter of its going to a premium.

As to the payment of commissions, European governments have found it of advantage to do this, not only in order to reimburse in this way banks, bankers and brokers in part at least for their out-of-pocket expenses, but also to encourage and stimulate competition among them in securing subscriptions. Much can be said in favor of this, and while it would help materially in placing our loans in this country, I think we can continue to do without it and rely upon the patriotism of financial agencies to do their utmost to secure subscriptions, even though it costs them money to do so. The same holds true of advertising expenses; with the mass of newspapers and publications of all kinds circulating in this country, the cost of paid advertising would probably be prohibitive, as all would have to receive consideration for political, if for no other reasons. The system, which Secretary McAdoo has adopted, of central committees in each federal reserve district, with a mass of local and trade committees to assist them, is probably the best method at our disposal to reach all the people of this country. It has been inspiring to see the readiness with which men and women have given their time and effort, to say nothing of their financial contributions. For instance, in the Second Federal Reserve District, about which I am best informed, it is estimated that the committee in the recent loan had made available to it by advertisers an amount of free advertising space which, if paid for, would have cost at least $1,000,000. This system of volunteer service has worked exceedingly well and has created a tremendous volume of enthusiasm and coöperation, which could hardly have been secured in any other manner.

The amount to be offered at any one time must be determined not only by the financial needs of the government, but also by the power of absorption of the public. England made her loan of last February an open one, with no fixed minimum or maximum, and secured over $5,000,000,000 from about 8,000,000 subscribers. Our first loan was limited to $2,000,000,000 and the recent one was in the nature of a compromise, with a minimum of $3,000,000,000 and an over-allotment to a certain extent permitted. Theoretically, the best way is an open loan in order not to be limited to the allotment of a definite amount. Each subscription then becomes an actual purchase and the machinery is much simplified. It is always easier to sell securities outright than to offer them for subscription, subject to allotment. This has been recognized in the last issue by the

acceptance of payment in full and allotment at once of subscriptions of less than $1,000, with immediate delivery of temporary bonds. The small subscriber does not want to sign a subscription blank, make a deposit and then go through a considerable amount of red tape before he gets the actual bond. He wants to pay for and receive his bond without any formality and with the minimum of bother. The same holds true to a great extent of those who are willing and able to take larger amounts. It seems doubtful to me, however, whether the country is ripe for an open offering and I am inclined to believe that the best results will be secured if we continue for the present, at least, the policy of offering a definite amount with a partial or possibly even an entire over-allotment permitted. The recent loan has furnished conclusive evidence that the American temperament requires the stimulus of having a mark to shoot at. It is apparent that the success of the offering was due primarily to every district, every locality, every agency knowing what it was expected to do and striving to provide its quota. The allotment of a definite share of the responsibility to each community and to every financial institution has proven its effectiveness, and I am convinced that if it had not been possible to make this appeal to local pride and individual rivalry, no such amounts of subscriptions could have been secured.

The matter of timing the offerings is fraught with considerable difficulty. It would be best, of course, if there could be a sufficiently long interval between issues to enable the accumulation of profits, income and savings, but with our enormous requirements, this may not be feasible and it may be that our offerings must follow each other in rather quick succession. England, however, has found it possible to let a longer period elapse between offerings and to rely in the meantime on receipts from taxation and on short time borrowing. Even in Germany, where there has been apparently very little, if any war taxation, there has been an interval of at least six months between issues. In the recent loan, we found that the response from corporate employes was inferior to that in the first loan, because they had not yet completed their payments on the bonds of the first issue to which they had subscribed and, therefore, were not disposed and probably not in a position to pledge any considerable further amounts of their wages and salaries in partial payment for subscriptions to the new issue. Another reason for avoiding, if

possible, offerings coming in too quick succession, is that both the public and the workers must be given a rest; otherwise enthusiasm is apt to be lessened and the issue may fall flat. The most effective method would be to so time our issues as to follow and have direct relation to military successes, or even failures. This would make the task of placing the bonds much easier on account of the psychological effect on the people of such happenings, but I realize that this procedure is hardly feasible.

The most important question which the Treasury Department has to determine in the case of each issue, subject of course to the authorization given by Congress, is the rate of interest, as with our policy of offering bonds at par, it is this which expresses the offering price and the return which the bonds yield. If our people are to invest readily in government bonds we must induce them to do so by offering them proper terms. It is all very well to depend upon patriotism for the sale of a certain amount of bonds, but the tremendous sums which this war requires to be raised by loans can be forthcoming only if the economic inducement to subscribe is proportionate to the yield of other investments. Experience, both here and abroad, has shown that while many subscribe from patriotic motives and with little consideration to the yield of the bonds, the main appeal must be based on the quality and attractiveness of the security itself as an investment. No citizen has the right in times of war to invest his savings as he likes, looking only to the security of the principal and the opportunity for profit. Business cannot and must not go on as usual during war and priority must be given the needs of the government, be they for steel, coal, money or any other commodity. But a fair price must be paid for money, just as for anything else, even though the government is entitled to the lowest possible interest rate and to have its needs supplied before those of private enterprise. The general trend of the investment market cannot be ignored with impunity. A certain margin between the yield of government bonds and those of other high-grade investments is permissible; if this margin is stretched too much the public may not respond. For the government to pay a liberal rate of interest on its loans is the wisest policy. It draws small and large savings to the Treasury and thereby discourages extravagance among the people at large, thus making it easier for the country to obtain the things it needs for the war. The rate of interest depends also on whether

principal and interest of the bonds are taxable or not and, if so, to what extent. It is readily seen that the higher the rate the less necessity there is for full or partial tax exemption, but on the other hand, if the rate is too high the effect on other securities is bad and may result in serious collapse. With our enormous requirements, however, we must attract all capital and savings, be they large or small. It has been said that making bonds tax free is a discrimination against the small subscriber, but is not the reverse also true? Why are not taxable bonds just as much a discrimination against the large subscriber, whose ready response to government loans is at least equally important? Would it therefore not be best if we offered the subscriber the option to take either a tax-free bond bearing a comparatively low rate of interest, or a taxable one at a rate approximating the return on high-grade taxable investments? The difference between the two could be about the average income tax on larger incomes, so that, except in special instances, which would probably not be very numerous, the net return of both classes would be substantially the same. Some specially situated might get some advantage from such a policy, but that can hardly be avoided when we are dealing with matters of such magnitude.

I favor the amortization of government loans by sinking fund payments, as heavy maturities are thus avoided. We are borrowing at low rates of interest compared to other belligerents, and are lending to our Allies at the same moderate rates. Would it not be better for us all if an amortization charge were added semi-annually so that repayment were spread over a number of years, instead of the entire amount coming due at one time? If such a policy were adopted it might be well to limit our special taxation for war purposes to an amount sufficient to provide for the interest and sinking fund on such bonds as may be issued. In fixing the method of repayment, we must have in mind not only ourselves, but also our Allies and be guided to a considerable extent by what is most convenient and least onerous to them. It may be necessary for this or other reasons for us to continue the policy of a fixed maturity, with the bonds subject to redemption at an earlier date, in whch case the maturity to be selected will depend upon various factors. If, in order to make the issue a success, a high rate of interest is necessary, the bonds should have a comparatively early maturity, as it is in the interest of the government that such a loan be refunded into a lower

interest-bearing issue at the earliest possible moment. It must not be overlooked, however, that the higher the rate the more desirous the investor is to insure the receipt of such return on his investment for the longest possible period and the longer the life of such a bond, the more attractive it becomes. Short time loans, such as our existing issues of Certificates of Indebtedness, are the easiest type of security to sell, as they have a special appeal to banking institutions and are for them a particularly attractive form of investment. But that is after all only temporary financing. In long time borrowing, the effect on posterity must also be considered. If the life of the bonds is very long, it is not fair to future generations; if it is very short, the burden is too great on the present one. The middle-road is probably the best, and I am inclined to think that unless the rate of interest must be materially increased, a maturity of from twenty to thirty years is probably the most desirable, both from the standpoint of the government and of the investor.

Of course, in the case of each issue, there are many questions of detail which must be settled, but as we become more experienced, these become simplified and more and more definite rules can be laid down. Such are the sizes of the pieces, the machinery of receiving subscriptions and of delivering bonds, the dates for payment, partial payment plans, terms of convertibility into future issues, war savings certificates and their relation to long time issues. The latter, as well as partial payment plans, are of great importance, as the loan of his savings to the government must be made simple and convenient to the small investor. It is towards him particularly that most of the educational work has to be directed and the result has shown that the man of moderate means and the wage-earner can be induced to invest in government securities, even though heretofore they may not have been buyers of bonds. The only class which it seems difficult to reach, are the farmers, and the response from them appears to have been unsatisfactory. It is strange that this should be so, as they are so prosperous. Their burden of taxation is comparatively light and the least we can expect is that they subscribe liberally to government loans.

The subscribers to small amounts find often considerable difficulty in providing for the safekeeping of the bonds they purchase. Most of them have no facilities for this purpose and many of them do not appear to have even a bank account. Many banks, trust

companies and safe deposit companies have offered their services free for the taking care of limited amounts of the bonds, but these small investors do not as a rule know how to go about it to avail themselves of these facilities, even when they are available. The government should provide some system by which the small subscriber would have a minimum of trouble and no expense in properly safekeeping the bond or bonds which he purchases. We might well follow the example of England and utilize the federal reserve banks in this country in a capacity similar to that of the Bank of England in Great Britain. As I understand it, any holder of British government securities can take them to the Bank of England, have them inscribed in one or more names and receive therefor a receipt, which is transferable only on the books of the bank. If the receipt is lost or mislaid the owner does not suffer as the inscription on the books of the bank is controlling and all that he has to do is to prove that he is the party in whose name the securities are inscribed. He need not produce the receipt, as long as he can prove ownership. Interest is paid by mail to inscribed holders, unless otherwise instructed, and if desired, the Bank of England will invest in government securities, the interest accruing to holders of amounts of less than £1,000.

Under the terms of the recent War Revenue Act, Certificates of Indebtedness issued under the act of April 24, 1917 and any subsequent act or acts are made receivable in payment of income and excess profits taxes. There seems to be no good reason why they should not be made receivable also in payment of federal inheritance or estate taxes. In fact, it should be provided that not only Certificates of Indebtedness, but all government bonds issued under any of the war acts be permitted to be used to pay the transfer tax on the estate of a decedent. Leaving aside any consideration of whether it is wise or proper to utilize an increased inheritance tax as a war revenue measure and to place special penalties on the accident of death during the war period, as well as of the fact that no provision is made for an abatement, if an estate changes hands more than once during a certain period, the actual payment of the tax should be made as little onerous as possible and such as to cause the least disturbance in the investments of an estate. As the law now is, the tax must be paid in cash within one year after the death of the testator, which means liquidation, possibly forced, of a considerable portion of an estate, while if the option were given to pay the tax

in government bonds or Certificates of Indebtedness, there would be a great inducement to wealthy men and women to keep a considerable portion of their capital invested in such securities, which after their death could be utilized for this purpose. An additional market for government bonds would thus be secured. An interesting provision of the English practice is that bonds are accepted in payment of death duties, excess profits duty or munition exchequer payments only if the bonds have been held continuously since the date of the original subscription or for a period of not less than six months immediately preceding the date of death or before such excess profits duty or munition exchequer payments become due and payable.

One of the greatest handicaps to the successful flotation of government issues is a weak and rapidly declining market for current securities. People do not feel encouraged to subscribe even to national loans when they see their other investments shrink alarmingly in value and when they find it impossible to liquidate except at great loss. Of course, the government cannot artificially stimulate prices, but it can avoid doing such things as cause loss of confidence and destroy real values. All that is needed is proper coöperation by all governmental agencies in seeing that business and industry are not handicapped. Fair rates for railroads, proper methods of taxation, sympathetic consideration of industrial problems and difficulties are far better selling arguments for government bonds, than myriads of posters or the most inspiring of speeches.

It is not within my province to discuss taxation or express an opinion whether the program adopted by Congress is a wise one or not. I wish only to point out that the investing power of the country is dependent to a great extent upon its ability to earn and save and that anything which affects this or handicaps business is certain to react unfavorably upon issues of government bonds. It has been said, that in the final analysis the tokens of exchange which we call money are but a convenient method of evidencing what they represent, namely, goods and labor. If this is so, and it seems to me sound, it follows that taxation is but another term for forced labor or commandeered goods, and government borrowing the acquisition of these by the state, with payment deferred until a later date, and rental—that is interest—paid in the meantime. In some communities, the option is still given the taxpayer to pay his local taxes either

in cash or by a certain number of days' work on the public roads, which is but an evidence of the recognition of this economic fact. There can be no doubt that the state has the right and is justified to commandeer or take without compensation a certain amount of the citizen's services or production, but it should not take more than he can spare without serious detriment to his standard of living or the proper development of his business. Otherwise, the result will be disastrous and its effect will be curtailment of industry, breakdown of efficiency, destruction of material prosperity and last, but not least, national discontent. Excessive or unscientific taxation is bound to have an unfavorable effect on government borrowing, as a discontented people will not respond readily to an appeal for its savings, to say nothing of the reaction on its ability to save. It has been said that the power to tax carries with it the power to destroy and that is certain to be the result of an unwise fiscal policy. Opinions may readily differ as to the amount to be raised by taxation, and the important consideration is not so much whether a larger or a smaller amount should be provided by a revenue bill, but the methods by which such revenue is raised. Taxation, in order not to interfere with government borrowing, must be based on sound and scientific economic principles and must not be haphazard in character to meet political or other considerations.

For the balance of its needs, after having recourse to taxation, the state must rely mainly on the sale of its bonds, that is, on borrowing the labor and goods of its people. This lending of their services and production must be voluntary on the part of the people, but the man who does not place at the disposition of the government at least part of the cash proceeds of his labor or goods is just as derelict in his duty as he who otherwise eligible avoids military service.

In order to make available the enormous sums which the war will require this country to raise by bond issues, the government must be prepared, if necessary, to monopolize the investment market. Not only can corporate securities not compete with those of the nation in their appeal for the savings of the people, but even state and municipal bonds, attractive as they may be on account of their exemption from taxation, must give way to the federal necessities. As long as governmental offerings are limited in amount and issued only at infrequent intervals, there may be room for the utilization of some of the national resources for other financial requirements, but

as soon as one government loan follows another in quick succession and for large amounts, the financial exhaustion is apt to be such, as to prevent the successful placing of other securities. It may be said that other borrowers can tempt money out of the pockets of the people by the attractiveness of the terms they offer, but even if this is possible, it should not be permitted in the interest of the country at large. The truest democracy lies in the subordination of the individual to the common good and the needs of the nation must be paramount. But how then are corporations and our political subdivisions to finance those needs, such as refunding and absolutely necessary addition, betterments and improvements which are imperative and cannot be postponed, if they are unable or not permitted to sell their own securities? It seems to me that there is but one logical answer to this question. The national Treasury may have to provide funds for this purpose just as it is financing the needs of our allies in this country. Our Allies must have the goods which we and we only can supply and our government is furnishing them with the credit with which to make payment, not only because that is the principal contribution which we can make at the present time to the battle against autocracy and brutality, but even more so because no such sum as they need could be found in the investment market of this country and what could be provided would be at such prohibitive cost as to interfere seriously with the financial stability of everything else. The same holds true of our own internal needs, and it is very apparent that heavy taxation and government borrowing has had its effect already upon the ability of our corporate enterprises to raise money. Look at the basis upon which prime railroad, industrial and public service bonds are selling, figure the cost of recent corporate financing and there can hardly be any doubt that the end is almost at hand, if not already reached.

The only securities which can compete are state and municipal bonds and that because they are free of all taxes. This is apt to make them more attractive to the large investor than government bonds when issued as entirely or partially taxable. Some means may have to be found to control the amount and time of such offerings and if the government should have to come to providing funds for the imperative needs of corporate enterprise, it may, even though not for the same reason, have to include in such a scheme provision for state and municipal requirements. Some may fear that the acqui-

sition by the government of corporate securities would be a step towards government ownership, but it does not appear to me that such reasoning is sound. These securities would be obligations, not stock, the relationship of the government would be that of creditor, not of owner, and the bonds and notes thus acquired would be in such form as to be readily salable after the war. In fact, it is probable that this could be done at a profit when normal conditions are again restored. Needless to say, the greatest possible safeguards would have to be adopted, so that there might be no abuse in securing government aid. If the time should come when such issues must be curtailed or even prevented, the most effective means of control and supervision would probably be through a central board, with power, possibly subject to review by the Secretary of the Treasury, to deal with this situation. Legislation may be necessary for this, but the main reliance would have to be placed on coöperation of public officials and of corporate managements and on the force of public opinion, which would probably be effective. This is not the time or place to discuss the details of such a scheme, and I desire only to point out that it is most important, if such a board should be appointed, that it consist of experienced men and be so constituted as to avoid any risk of outside considerations affecting any of its decisions of the important questions with which it would be called upon to deal. It would have to be assisted by regional and advisory committees, so that the best local opinion and technical judgment could be secured. All of the belligerents and some of the neutrals as well have found it necessary during the war to establish supervision and control over the financing of capital expenditures by public issues and to limit the demands for capital on their markets. If the war continues for any length of time, we also may have to do something on these lines in order to make all of our funds available for the government.

Few people seem to grasp how enormous our war requirements are. Congress has thus far appropriated over $21,000,000,000, and it is estimated that over $19,000,000,000 of this amount will be actually spent during this fiscal year ending next June. There is, of course, no such amount of money available in this or any other country and credit must be created to take care of these tremendous needs. We must win this war and make every sacrifice necessary to do so, but it must not be overlooked that there is a limit

to what even a country as rich as ours can provide. There should be, of course, no niggardliness or false economy, but on the other hand, extravagance must be checked and unwise expenditures avoided. This has a direct bearing on government loans. The people must feel that the money they provide is being spent wisely, otherwise they are apt to hold back. We must bear in mind that even our purse is not bottomless and our resources without end. There is a limit to what can be raised safely by taxation. There is a limit to the power of absorption of government loans. There is a limit to expansion of currency. As the war goes on, we must have recourse to all these methods of raising money, but the last must be used only on sound economic lines and with the utmost caution. We must avoid greenbacks, and any creation of additional currency should come through the federal reserve system, which is amply able to provide for a large expansion on a sound basis. Upon the present amount of gold held by the federal reserve banks about $2,000,000,000 more reserve notes could be issued than are at present outstanding and even that great amount can be increased by the Federal Reserve Board by decreasing the gold reserve required. In order to thus expand our currency, eligible commercial paper and acceptances must be provided. We need additional currency to support our government loans, and the industries of the country and individuals must furnish the basis for the enlargement of our currency supply. Our people must learn to borrow and our banks to rediscount. This is the way to provide the credit needed by the government. It is a circle which produces results. Current savings are not sufficient; the people of the country, merchants, manufacturers, farmers and wage-earners, must pledge their future savings as well. They must borrow from their banks and invest in government bonds the funds thus received. The banks in turn must rediscount their customers' notes at the federal reserve banks, and additional credit facilities are thus created. The money thus furnished the government returns to the people through the channels of trade and thus becomes available again for further investment in government bonds. This process may be pyramiding, but it is economically sound, as it is self-liquidating as the people of the country repay their debts out of their savings and out of the proceeds of their production, be it labor or goods. To accomplish this, our people must be taught to save and avoid unnecessary expenditures.

Our banks also must be educated to make full use of their rediscount facilities. Some of them still seem to think that to avail of the federal reserve banks' facilities is the same as taking out clearing house certificates in times of panic and that it is a sign of weakness if their statements show that they have rediscounted. I cannot emphasize too strongly the need of economy and of the public availing freely of the borrowing facilities which must be provided, as on these depend primarily the successful flotation of bonds of our government.

I have not ventured, nor do I propose to outline or recommend any definite plan for borrowing by our government or to express an opinion as to what the amount, rate of interest, maturity or time of issue of the next or future offerings should be. All these are matters which the Secretary of the Treasury must determine when the time comes with relation to conditions and requirements as they may develop, and I am confident that we can rely with safety in the future, as we have in the past, on his wisdom and good judgment and on that of his advisers. Not only can no hard and fast rules be laid down as to the exact form which government loans should take in this country, but it would be presumptuous for me to try to do so. All I have attempted in this paper is to present a brief outline of some of the factors which must be considered in connection with government borrowing, and certain principles which seem to me must be observed, not only to ensure a ready popular response to bond offerings by our government, but also to make it possible for the enormous sums needed to be forthcoming. These requisites, which, in my opinion, are of paramount importance, I would summarize as follows:

There must be no hampering of enterprise by unwise or too onerous taxation.

The public must not be discouraged and values must not be jeopardized by an unfriendly attitude by the government towards business. Capital as well as labor must be permitted to earn a fair return.

Issues of government bonds must not be too frequent and must not exceed the absorption power of the people. There should be, if possible, sufficient intervals between offerings to enable accumulation of profits, income and savings and to prevent exhaustion and lessening of enthusiasm among those actively engaged in placing the bonds.

A fair rate of interest must be paid and one not too much lower than can be secured from other prime and readily salable investments.

There should be no discrimination between large and small investors and, in so far as possible, the net return to all subscribers should be substantially the same.

The fullest possible facilities must be provided for borrowing by the people of the country and the federal reserve system must do its full share to make available its resources for this purpose.

The national government must monopolize the investment market if necessary, and is entitled to have its money requirements supplied before and, if need be, to the exclusion of those of private enterprise or even of states or municipalities.

Last and most important, the people must be taught to save and all unnecessary expenditures must be avoided. Thrift and economy must be the rule.